RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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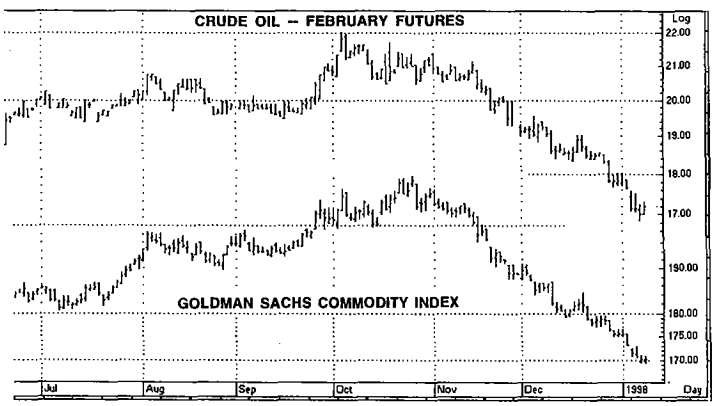
Jan. 14, 1998 **LETTER 1243**

1997: What were the most distinguishing features of 1997? In my opinion, it was the dominance of the **global economies**, the internationalism of investing and the instantaneousness of communications. As columnist James Goldsborough put it, "South Korean banks borrowed Japanese yen earned from Tokyo's surpluses with America -- to invest in Thai companies exporting through Hong Kong." Global markets (read foreign exchange markets or FOREX) proved to be more powerful than governments. In the new global economy, trade expanded to record levels, the smartest and the most powerful nations did well, but there was also a downside -- an economic virus in one country could spread overnight to another country or to the rest of the world.

1998: What will be the most distinguishing feature of 1998? Already, it's two phenomena: **(1) deflation** -- every commodity from corn to hogs to copper to oil is heading down; **(2)** the **collapse in Asia,** and remember, Asia represents **one-third** of the world's total economy.



RECORDS, RECORDS: The Dow rose for seven consecutive years through the end of '97. In the 100 year history of the Dow, this has never happened before. Next, the Dow recorded three consecutive years of over 20% gains. This has never happened before (gains: +33.45 in '95; +26.01 in '96; +22.64 in '97). And a third absolutely incredible record -- in the 15 years since 1982 the Dow has never closed below the low of a preceding year. Still more -- from 1987 through 1997 the Dow advanced over 300%. This represents the best 10-year stretch in Wall Street history. Finally, in '97 the total value of US stocks was 120% of the nation's entire Gross Domestic Product, a situation which went far beyond anything seen in 1929, 1966 or 1973 (at the 1929 top the US stock market was valued at about 85% of GDP).

Here's an interesting **question:** In view of the above, could the stock market have **already discounted** the BEST that can be seen ahead? **Answer:** I don't know, and nobody on the face of this green earth knows -- yet. But this is worth pondering -- each time the market establishes a record, it becomes increasingly difficult to stretch that record another notch.

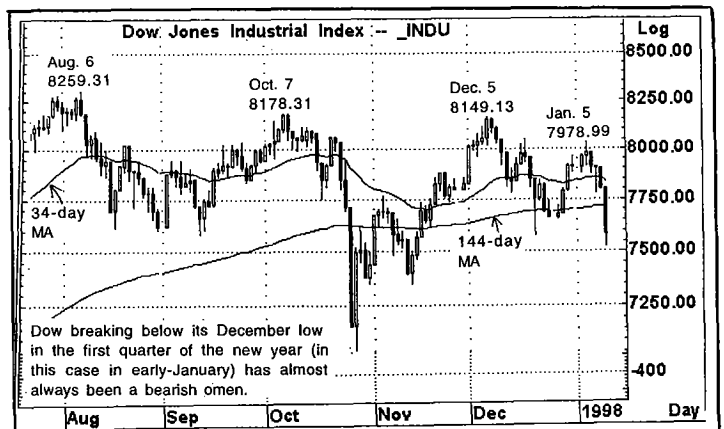
Asia: I don't think investors realize the **severity** of the Asian crisis. My friends at *13D Research* [(208)726-1565], who do outstanding research, write, "The current loss of wealth in Asia is unprecedented in modern history." Following are **losses** in terms

Jan. 2 DJIA 7965.04; PTI 5190; A-D Ratio +10.41
Jan. 9 DJIA 7580.42; PTI 5184; A-D Ratio +9.24
Dow Yield: 1.81%; Dow Price/Earnings: 19.4
Dow 144-day MA: 7713; Dow 34-day MA: 7839
Dow Times Book Value: 5.36; PTI 89-day MA: 5109
Percentage of Undervalued Blue-chips: 3%
Gold 34-day MA: 293

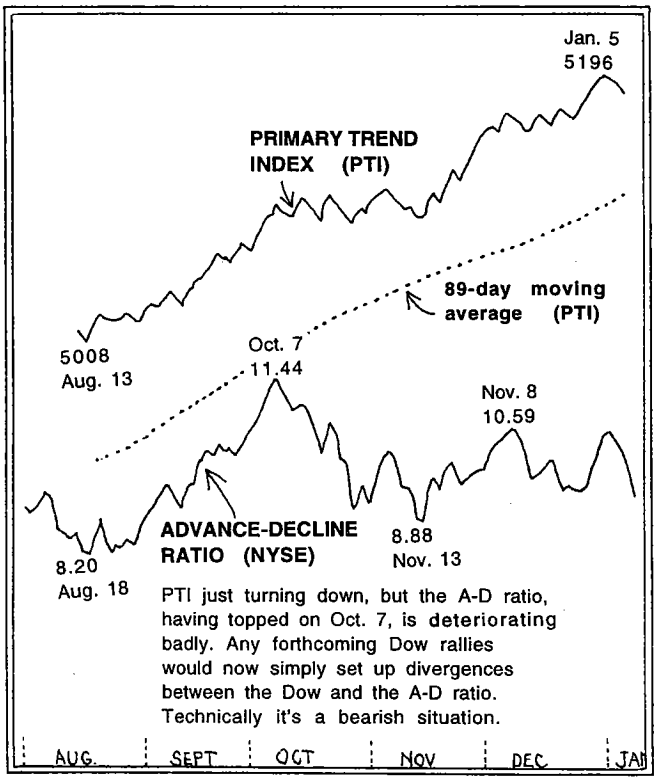
of GDP in local currency terms: Hong Kong -- 141%; Indonesia -- 21%; Japan -- 97%; Korea -- 24%; Malaysia -- 222%; Philippines -- 50%; Singapore -- 81%; Taiwan -- 31%; Thailand -- 83%. **Russell comment:** Absolutely unbelievable. **And there's more:** China, probably the key to Asia, is heading for recession. *13D* notes that the China World Index fell 16% in '98, 10% alone on January 7. Major trouble will hit if China decided to devalue again.

US Money: The US money supply (which nobody seems to pay attention to anymore) has been going through the roof. If it wasn't for the Asian mess, inflation would almost certainly be heating up in the US -- of course we're already seeing inflation in housing and in high-priced luxury items.

Question: OK, Russell, no question about it, the money supply is surging, but why is the Fed, which is supposed to guard against inflation, allowing this to happen? **Answer:** The Fed is allowing it to happen because the US is the world's only economic locomotive -- and the Fed knows that it must keep that locomotive moving. The US is THE market that every nation sells to. The Fed is content to allow the money supply to sky-rocket in order to offset the deflationary pressures coming out of Asia. I also think that the



Dow Study: Few investors realize it, but since its August 6 high, the Dow has traced out a series of four declining tops as seen on the chart. This tells us **that each successive rally since August 6 has been weaker than the preceding** -- never a good sign. On Friday, January 9, the market finally showed signs of "unraveling." On that day the Dow plunged below its long-term or 144-day moving average and even more **important it plunged below its December 24 low of 7660.13 on huge volume.** It's a bearish indication when, anytime during the first quarter of the new year, the Dow breaks below the low of the preceding December. **Question:** Why do you put so much emphasis on the Dow? **Answer:** Because the Dow is the most watched and analyzed stock market indicator in the world. **It's the World's Barometer.** When the Dow moves up or down on a **trend basis,** it possesses both financial and psychological implications.



collapse in gold is fortifying and justifying the Fed's stance regarding the surging money supply. Declining gold along with very weak commodities provides the Fed with the incentive to keep the money supply surging.

THE PICTURE, 1998: I ask myself, "Does the Japanese morass represent the enormous potential danger, the spreading financial sickness that can derail the greatest bull market in US history? The truth -- no one knows, not the *Financial Times,* the *New York Times* or any other times. Personally, I doubt that the Japanese picture or even the entire Asian picture alone can or will doom the great bull market.

There are too many other factors. The bull market is ancient, it's old in the tooth. Yields are almost non-existent for most stocks, the market has gone on for years without a major correction, evaluations by any count are off the statistical charts. And to top it all off the public has developed an almost mystic affection and faith in stocks, stocks not only as investments but as a trusted form of savings.

I believe the Asian disaster could simply be the **trigger** that topples the bull over, but it is not the lone item that finally kills the great bull. As my older subscribers know, bull markets and bear markets end in only one way -- **exhaustion.** Bull markets end when the last buyers have done their buying and a growing army of sellers become the dominant force. Bear markets end when the last sellers have dumped their stocks and when the buyers (who have been quietly accumulating) become the dominant force.

PRIMARY TREND: The most important fact for investors to be aware of is whether the **greatest single force in the market,** the primary trend, is bullish or bearish. If the primary trend is bullish, we can liken it to the incoming tide of the ocean. Despite counter-waves, despite confusing ripples, if the tide is coming in, it will ultimately raise everything up with it. On the other hand, if the tide is running out, the relentless power of the tide will ultimately sweep everything out to sea.

At any given time, the primary trend of the market is either bullish or bearish. But there are periods, often extended periods, when the primary direction is hidden or at least unclear. At such times, we fall back on that old Dow Theorem, the TREND CONTINUES UNTIL PROVED OTHERWISE.

The primary trend was last confirmed as bullish on August 6 when both the Dow and the Transports recorded new bull market highs. Since then the Transports have advanced to new highs. **But the Industrials have persistently refused to confirm.** As I have repeated over and over again, the Industrials have never advanced above their August 6 closing high of **8259.31.**

Of course, that doesn't mean that Industrials can't or won't ultimately better their August 6 high. But the fact is that month after month has gone by without an Industrial confirmation. Consequently, I have grown increasingly suspicious. Why hasn't the Dow bettered a high that it recorded more than five months ago? Why, with all the bullish predictions and optimistic scenarios, have the average of thirty of the greatest blue-chip corporations in America refused to better a mark that they hit over five months ago?

The mystery continues, and until it's solved, I'll check any urge I have towards bullishness. Japan, Asia, the American fund-buying public, business in '98, the China question, inflation/deflation -- there are a thousand variables in the picture, but it all boils down to the ability or inability of the D-J Industrials and Transports to better their preceding highs. And so far it's clear that **they have refused.**

According to Dow Theory, **everything** anyone knows about forthcoming political, social or financial events is reflected in the action of the Dow Jones Averages. Each hour of the day the knowledge of tens of millions of speculators and investors filters into Wall Street via the Averages.

The **critical points** for the Averages are now **clearly defined.** If the Dow and the Transports can better **8259.31** and **3368.33** respectively, the bull market will be reconfirmed and the stock market picture will be labeled as decisively bullish.

Conversely, if the market turns down and the Dow and the Transports break below **7161.15** and **3004.58** respectively, then a primary bear market will be signaled, in which case it will be time for me and my subscribers to head for the storm cellars.

However, there's nothing in Dow Theory that tells us that we have to wait for an actual Dow Theory bear signal before exiting the stock market. The singular (may I call them ominous) events of the last six months have been more than enough for me.

Personally, I have been out of stocks, and I have suggested that my subscribers do the same -- I am, as you know, heavily invested in Treasury bonds. I haven't liked the stock market action since last August. I haven't like the flagrant non-confirmation, and I haven't liked series of lower peaks in the Dow, and I haven't cared for all the bullish hoop-la about what a good 1998 we have in store for us. Finally, I haven't liked that "buy-all-the-dips" philosophy that seems to have become ingrained in the American psyche.

Indicators: The "January Indicator," what the market does during the first five trading days of the new year (or what the market does for the whole month of January),is supposed to tell us what the market will do for the entire year. Should we believe it? **My advice:** Forget these automatic rules. They are like the cycles -- "where are they when you need 'em?" Peter Eliades draws attention to the "8" years in the decennial cycle (i.e., 1938, 1968, 1988) Peter notes that over the last 100 years the low for the "8" year has always arrived between January 15 and March 31. **Russell advice:** Expect this year to be **different.** This entire market has been "different."

PRIMARY TREND INDEX (PTI): For my thousands of new readers courtesy of Marty Zweig I want to explain my PTI. First, a little history. Back in the '60s it was obvious that Wall Street was finally accepting technical analysis. Charts, patterns, odd lot studies, short interest ratios, moving averages. Suddenly it became acceptable to discuss the market in so-called technical terms.

Around the mid-'60s, it occurred to me that too many market analysts were following the same indices and studies. For this reason, I felt that I needed to develop some sort of indicator of my

own, a proprietary indicator. But it would have to be a device based on **market action**, based on what the market was actually doing, minus guesses, adjustments, and judgment calls.

I decided on a composite of eight absolutely basic market items. As long as the **majority** of these eight items were advancing it would be impossible for the market to decline on a trend basis. The converse was true as long as the majority of these eight items were declining on a trend basis.

Having developed my PTI, I needed some sort of "signal" device which would automatically tell me whether to grade the PTI bullish or bearish. By a process of trial and error I concluded that an 89-day moving average would constitute the best dividing line between a bullish or a bearish interpretation of my PTI. As long as the PTI held ABOVE the 89-day moving average, the market would be classified as bullish; the converse would be the case when the PTI broke below and held below its 89-day moving average.

I've included a chart of the PTI in every issue of Dow Theory Letters since 1971. Veteran readers can attest to the usefulness of this composite Index over the last 26 years. Many times the PTI has saved me from making a wrong call or in other cases the PTI caused me to "pull back" or reconsider my bullishness or bearishness.

For instance, right now it's a bit difficult for me to "feel" bullish about this market. Yet my PTI continues to hold well **above** its moving average, and on top of that -- on December 29 the PTI rose to a **new record high**. So, if nothing else, the PTI keeps me humble. Which is not a bad way to be if you want to survive in the investment business.

I might add that to make it easier for subscribers to identify my overall market view, I place either a bull or a bear in the **Investment Position** box of each Letter. The bull has inhabited the box over recent years. He's old, he's long in the tooth, he's suffering from arthritis in his left front leg, but he's still in the box, and he's still able to snort.

Finally, the PTI is the only "secret" I have. The PTI is a proprietary indicator, and the reason I keep it a secret is that I'm afraid that if its construction became general knowledge, too many people would use it, and it would somehow lose its effectiveness.

INVESTMENT POSITION: I don't have definitive proof of a primary bear market yet, but with the smashing of the December lows I'm pulling the bull out of the box and replacing him with a question mark. My guess is that the next resident in this box will be -- bruno, the bear.

The combined losses in values so far from Asia and more recently in the US are the greatest in history with literally trillions of dollars going down the drain. The losses, so far, surpass anything seen during the '29 crash. Our job -- to avoid being part of the loss parade, but it won't be easy. Veteran subscribers probably remember the old Russell adage -- "In a bear market the one who loses the least is the winner."

It's difficult to decide at this early stage of the game where the safest place to be is -- so far, certainly, it's been US Treasury bonds, which at this writing are continuing their spectacular advance. In my opinion investors are not buying bonds simply for yield; no, I think the surging bond market is making a statement -- the statement -- with trillions in values being wiped out **the odds for actual deflation are increasing by the day.**

If you haven't already moved into bonds, I now suggest purchases of 2-4 year Treasury notes. My reasoning: IF this is fated to be a true bear market it could last 2-4 years, and in buying 2-4 year T-notes you'll be locking in current "high" interest rates. But if everything turns out happily, you'll still be holding one of the most liquid securities, securities you can sell at a moment's notice with little chance of significant loss.

NOTES & QUOTES: "What me worry?" Not the US consumer. The Conference Board's Index of Consumer Confidence jumped to 134.5, the highest level since 1969. Meanwhile, the National Association of Purchasing Managers' Index of factory activity dropped from 54.4% in November to 52.5% in December. Anything below 50% indicates a contracting economy.

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The dollar continues to surge (which is deflationary) and the yen (and almost every other currency) continues to sink against the dollar. Some observers believe that the yen could be heading for 140 to the buck (at which point, Japanese goods will be super-competitive and the pressure will increase even further on prices of US goods). The one thing militating against all-out deflation in the US is the surging money supply. The Fed has the "pedal to the metal."

* *

Commentators are talking about (wondering about?) Clinton's presidential legacy. One legacy is Clinton's amazing "reverse-Midas" touch, meaning that everyone around him ultimately gets indicted. A second moment frozen in time is Clinton's historic picking of a name for his new dog (the name chosen was "Buddy"). Finally, Clinton will be remembered as the President who told us that the current tax system (with maybe a few "simplifications") was the right one for Americans. **Russell Opinion:** Clinton will go down in history as a political rascal who was saved by the greatest bull market in history. Problem -- we still have two more years of Clinton and the bull market may not last that long.

* *

What's the fastest-growing age group in the US? It's the over-100 crowd. Currently there are more than 50,000 Americans that have passed the century mark. How do they do it? Here's how: **(1)** They have learned how to manage stress. **(2)** They rarely show anger. **(3)** They don't tend to fret and stew. **(4)** They enjoy a joke and have a sense of humor. **(5)** They tend not to be neurotic. **(6)** They tend to be conscientious and dependable. **(7)** They do everything in moderation. **(8)** They don't smoke or if they did they quit decades ago. **Russell comment:** My mother lived to be 92. Her attributes: she was totally dependable, avoided stressful situations, was very thrifty and when asked what her "secret" of longevity was, she answered that "she did everything in moderation." Her childhood friend, Amy Sneider, lives here in La Jolla. Amy is now 103, is in a wheel chair but is mentally as clear as she was when she was 70. Amy was born in 1894, and we all hope she'll live to 2000 and beyond. Imagine, being there during the 1800s, the 1900s and the 2000s.

* *

I'm not a traveler (I find the stress of transportation more frustrating and stressful than any joy I receive when I arrive). But traveling is a big item today, and here are the **most popular destinations** (based on international tourist arrivals in thousands): France -- 62,406; USA -- 46,325; Spain -- 41,295; Britain -- 25,293; China -- 22,765; Mexico -- 21,405; Hungary -- 20,674; Poland -- 19,410; and Canada -- 17,286.

* *

Good Life. Says *Buzz* magazine (Jan. '98): "We've never seen anything like Beverly Park, the most lavish, expensive, in-your-face grandiose, gated-and-guarded house community on earth. The California community with its own private canyon above Beverly Hills has homes starting at $10 million and boasts such personages as Rod Stewart, Denzel Washington, Pia Zadora and Magic Johnson. The two-acre plots feature, aside from movie, rock and sports stars, tycoons and billionaires from around the world. One Mexican media mogul bought four adjacent plots, one for each of his four children. And no, tourists with star maps will not see Beverly Park."

* *

You want to know what **Hollywood** is really like today? Listen to this (courtesy *W* magazine) from an interview with Danni Janssen, leading Hollywood hostess and widow of the late David Janssen

of "The Fugitive" fame. "Nobody runs Hollywood anymore. Those days are over. Lew Wasserman did. He was the industry, but things changed after he sold Universal to the Japanese. Today, some people assume they're the powerhouses. But even studio heads don't run the town anymore -- the last Academy Awards proved that, with all the independents winning. In the '90s I think everybody out there is on their own. Everyone has a certain amount of power depending on their last picture. The money structure is different today. Stars make astronomical amounts. Probably they're worth it. While a star is big today, he can get $20 million a picture. So during the $20 million picture, he's a power. But he's out there on his own, nobody's backing him. Nobody's secure. Everyone is as insecure as the next guy. An actor can be the biggest star, but the minute they stop working, they wonder what they're doing next. It just comes with the territory. I don't care if you have $500 million in the bank or $5, it's the same. With movie people you have to be careful what you say. It's generally not a good idea to ask the usual question: what are you doing? Lots of them aren't doing anything. One guy might be gigantic in March, and here it is July, and he doesn't have a job. It's better to say, 'How are the kids? What are you doing on the Fourth?'"

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One of the biggest events of '98 will be the World Cup of soccer, which will be held this year in France. Soccer is THE world sport, and it's evolving into one of the largest businesses on earth. The World Cup will be contested by 15 European nations, five African, five South American, four Asian and three from North and Central America, including the US (whose love of baseball will be further undermined). Soccer throughout the world is becoming a force to rival Hollywood. Football is an American sport. Soccer is a world sport. The odds-favorite for the World Cup winner -- Germany . . . Meanwhile, here in San Diego, the city is preparing for Super Bowl XXXII. Tickets are going for $1,500 a piece if you can find 'em and local hotels and restaurants are warned not to gouge the visitors. We'll see about that.

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A few expressions emerged during '97 that were so cynical, **so awful**, that they may be banned from the language for years to come. Here are a few choice items: **(1)** "Mistakes were made," Clinton's answer to the disgraceful fund-raising by the Democrats. **(2)** "No controlling legal authority," Al Gore's disgusting, almost comic excuse for using his White House office to raise campaign money. In the financial category we have **(3)** "Show me the money," the ultimate expression of greed, courtesy of the movie, "Jerry Maguire."

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The *New York Times* (Dec. 28) gave out its "Financial Follies" award for '97. Alan Greenspan won the "Hamlet Decisiveness Award" as the *Times* noted, "To Alan Greenspan, chairman of the Federal Reserve Board. Having sounded the alarm about 'irrational exuberance' a year ago, by spring he was sending out the word that he wasn't alarmed. Indeed, he indicated that he saw merit in the 'new paradigm' theory, which holds that growth without inflation will continue forever. By fall he backed away from that stand. So what did Greenspan do except talk? Nothing."

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The '97 Christmas season was disappointing for most retailers. It seems the public is less and less enamored of spending their money in that financial orgy that Christmas has become. However, the Big Ticket items (items bought by the wealthy) were the winners. Writes the authoritative *Women's Wear Daily*, "Those spending serious money, at least five figures per item, during the holidays are turning to fine jewelry and watches. Though often loathe to discuss the specifics of their sales receipts, fine jewelers and watchmakers were nearly dizzy relating tales of holiday shopping this year." Said Cartier: "As of now, we're trending 30% ahead of last year around the country." Said Van Cleef & Arpels: "There are really two economies that are affecting us this year, Wall Street and Hollywood" . . . Said Piaget: "We've been selling first-time engagement rings of two to three carats instead of the usual one. In the past large pieces were purchased by Middle Eastern or Asian customers, but today it's Americans."

* *

The weak yen and the super-strong dollar are generating sales pressure and angry words from the Big Three US auto makers. For instance, a Japanese car that could be built for the yen equivalent of $20,000 in July can now be built for $17,000. Through November Big Three car and truck sales are down 4% while Japanese sales are up 4%. The biggest gains by far are from Honda, where car shipments are up 43.7% from '96 and truck sales are up 290%. Mercedes, which is now producing cars and trucks in all price ranges, shows sales up 15% over last year, to a record level. But the publisher of *Automobile Magazine* claims that the dollar/yen controversy masks the Big Three's real problem -- how to wean all those baby boomers away from the Japanese cars that they have grown to love.

* *

Pining away for a totally new **US tax system**? As they say in Brooklyn, *for-ged-aboud-it.* Not while Clinton is president. Clinton is planning a "tax counterpunch," meaning that he's against offering any major proposals to cut or simplify taxes. Clinton is gambling that he can successfully counter GOP plans by portraying them as regressive and irresponsible. **Russell comment:** We won't get a new tax system until we get a Republican in the White House and a Republican majority in Congress. Clinton will always opt for the status quo plus anything which will keep the power to manipulate in the hands of the politicians.

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From a recent interview with IRS chief Charles Rossotti: **Question:** "When was the last time you did your own taxes? What was it like?" **Answer:** "I'm not too keen on answering personal questions. Let's just say that for the most recent years I've been working with a tax accountant who I've worked with closely for a long time."

* *

The high-priced sneaker revolution may be drawing to a close. Leading athletic shoe makers are showing a decline in sales. Teenagers have stopped killing each other for the latest in hot athletic shoes. On the market now are $20 to $55 imitations of the $150 killer-diller sneakers with the air-flow soles and the special shoe-lace designs.

* *

Economists have been amazed at how fast the Asian crisis developed. Writes David Fuller [*Fuller Money* out of London (7 Swallow St., London WIR 7HD)], "The International Monetary Fund, despite having approximately 1,000 economists (or was it because of them?) on 19th St. in Washington, was praising the Korean economic model along with Thailand, earlier in the year. In the Fund's 1997 annual report, issued a few months ago, 'Directors welcomed Korea's continued and impressive macro-economic performance (and) praised the authorities for their enviable fiscal record.' Additionally, directors strongly praised Thailand's remarkable economic performance and the authorities' consistent record of sound macro-economic policies." **Russell comment:** So much for the IMF's predictive ability. Well, at least we have the brilliance of our own Fed.

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Interesting statistics, particularly for those who like to buy stocks with a high sales-to-market capitalization ratio. Note Microsoft selling at a huge 13.8 times sales whereas Exxon sells at a little better than one times sales (note revenues are based on 1996 statistics).

Top 10 companies by market value IN BILLIONS OF DOLLARS

COMPANY	MARKET VALUE*	1996 REVENUES
General Electric	$242.2	$78.5
Coca-Cola	158.9	18.5
Microsoft	157.9	11.4†
Exxon	152.1	116.7
Merck	125.9	19.8
Intel	113.0	20.8
Philip Morris	109.0	54.5
Procter & Gamble	106.7	35.8
IBM	97.2	75.9
AT&T	96.0	64.9

Consumer debt. Consumers now carry $1.2 trillion in installment debt, up 50% from just four years ago. The average credit-card enthusiast has at least four credit cards and is carrying roughly $4,000 in high-interest debt. Consumers have become overextended, based on the high level of credit card delinquencies and the record level of personal bankruptcies.

* *

Running a small business in America isn't always easy, even though over a million small businesses are added to the economy in a good year. Here are the **major gripes** of small business-owners in order of their importance. **(1)** Health-insurance costs. **(2)** Federal business tax. **(3)** Wage costs. **(4)** Unreasonable government regulations. **(5)** Social Security taxes. **(6)** Occupation costs. **(7)** Federal paperwork. **(8)** State business taxes. **(9)** Changes in tax law. **(10)** Cash flow.

* *

It's almost certain that the euro, Europe's long awaited single currency, will come into being before the year 2000. Eleven of a possible 15 nations will join the Euro club. Based on current predictions, as much as $1 trillion of international investments may shift from dollars to euros. Thus, the bi-polar system, dominated by the US and Europe, will be unseated. The dollar and the euro will each likely end up with 40% of the world's finances with 20% remaining for the yen, the Swiss franc and other minor currencies.

What's a euro going to be worth? A new option called the Eurostart is now being traded on the London exchange. Investors can speculate on which of five price ranges the euro will be trading in against the US dollar.

* *

I've never in all my years seen Americans so disillusioned with government. During the Clinton Administration, cynicism has reached a new high. Nothing is considered too crude, manipulative or illegal for the White House. The Congress is seen as weak, self-serving, gutless, and mainly concerned with its own re-election. How could all this have come about? As I see it, the great bull market has done it; the bull market has acted as a soothing syrup, covering all with new money, new jobs, new toys, and a feeling of confidence and security.

* *

Years ago I opined that the ruble would be a junk currency unless the Russians backed the ruble with gold (and, of course, Russia is a big gold producer). But the Russkies evidently listened to American advisors and sure enough, the ruble became a junk currency. Last week Russia did the inevitable, they knocked three zeros off their currency. Overnight 6,000 rubles to the dollar became six rubles to the dollar. This is the third time in seven years that the Kremlin has overhauled its currency (the previous two attempts led to widespread panic as people feared the change would make them poorer).

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The car business isn't going to get any easier. Chrysler announced that is has a plastic that will produce a revolutionary car body that needs no paint. The new plastic could create a car body with only six parts instead of the current 80 to 90. The new technique could conceivably halve the price of a conventional vehicle. Meanwhile, Mercedes announced that it is looking for a partner which would allow it to turn out cars at lower ranges than its current luxury line.

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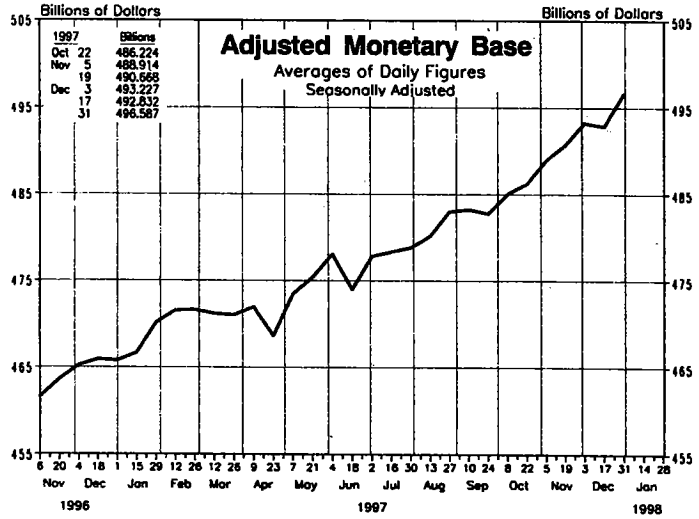
Advice for the ladies from the great Sophie Tucker: "From birth to age 18 a girl needs good parents. From 18 to 35 good looks, from 35 to 55 a good personality, and from 55 on -- cash." Here's advice from the late Jolie Gabor, a believer in women in business; she's the mother of the famous Gabor sisters. "When you can support yourself, you can choose your husband. You don't have to be the slave of a rich man." Her advice on how to catch that husband, "Beauty to capture, brains to hold."

* *

A famous psychiatrist (Frederick Perls) said when dealing with his patients, "I don't listen to the words, I listen to the music." In other words, it isn't necessarily what the patient says (which is often what he thinks the doctor wants to hear), it's what the patient is doing. As a matter of fact, Perls once stated, "Everything you want to know about a person will be revealed if he will honestly answer three questions, (1) what do you want? (2) what are you thinking? (3) what are you doing?"

My own formula is this -- everything is revealed about a person if you can know what he is doing or would like to do regarding (1) sex, (2) food, and (3) money.

Using the philosophy of the above, we ask, "Forget what the Fed is saying, what's the Fed doing?" And the answer is provided by this chart which just came in from the St. Louis Federal Reserve. It shows that the Adjusted Monetary Base is surging up at roughly a 10% rate (compounded annual rate of change). No question about it (in case your neighbor asks), the Fed is pumping away, trying to offset powerful global DEflationary pressures.



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My son Ryan (age 19) is down here on vacation from Berkeley. I asked him out for dinner tonight. Ryan, "Dad, do you like lobsters?" Me: "Yeah, do you want to go to a seafood restaurant?" Ryan, "Well, Adam and I are going diving for lobsters this afternoon, and I thought we could cook some lobsters tonight." Me: "Well, just be careful, and wait, do you have a lobster-fishing license? You're in big trouble if you catch lobsters without a license." Ryan: "Don't worry, Dad, we've got licenses to catch up to seven lobsters each." Me: "OK, I'll have the pot boiling." And that's the way it goes in California.

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Here's a little more about the Golden State. California's gross state product topped $1 trillion in '96, a benchmark not reached by the entire US until 1970. It is so big that agriculture, the state's number 2 industry after electronics, produces twice as much as the second largest farming state (Texas) and almost as much as the combined output of Iowa, Nebraska and Illinois. Here's a rundown of the world's largest economies in trillions of dollars. US -- $6.7 trillion; Japan -- $4.3; Germany -- $2.0; France -- $1.35; Britain -- $1.06; California -- $1.03.

* *

Are they making money in NYC? Better believe it. A lot of the big guys are now renting, and some of the rents are hitting SIX figures. According to the *NY Times* (Jan. 8): "In the last year there have been more than 60 rentals priced at more than $25,000 a month . . . Just a year ago agents were saying these types of rentals were almost non-existent. Now, agents complain, their only problem is finding enough of them for temporarily homeless millionaires . . . Beatrice Cucrot of Stribling Assoc. said one of her listings, a $27,000 a month co-op rental on Central Park West with nine rooms and a handful of terraces had 'people lined up, three and four deep.'" **Russell comment:** Yeah, Wall Street had a very, very big year.

* *

The January 5 *NY Times* headlined an article, **"Fed Awaiting Clear Signs at the Crossroads."** According to the *Times*, here are the two cases the Fed is considering:

Case 1: The economy continues to expand briskly this year. The unemployment rate remains low, and employers have to raise wages to attract the workers they need to keep up with demand. To maintain profit margins, companies start pushing prices higher, and before long inflation again becomes a threat to destabilize a business expansion that is nearly seven years old.

Case 2: Asia's economic woes continue. Manufacturers in countries like Thailand and South Korea flood the market with goods made cheap by their devalued currencies. Jolted by competition from abroad, United States manufacturers cut prices. Financial markets tumble, and the economy grinds to a halt. Soon the big threat is from a decline in the general price level — deflation — a phenomenon the United States has not experienced since the 1930's.

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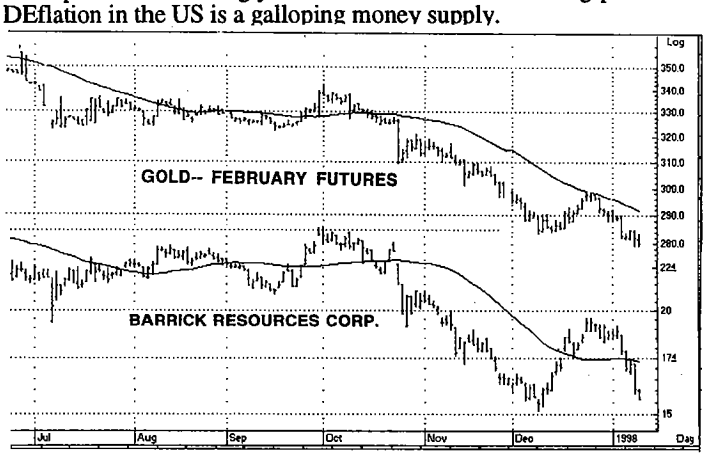
GOLD: This is a fascinating picture. As mentioned earlier, the situation in a large part of the world is deflationary. Prices of almost all tangible items are heading down. The Japanese "bubble" has collapsed, currencies across Asia have fallen apart, competition for exports is increasingly vicious. What's counter-acting potential DEflation in the US is a galloping money supply.



This provides a strange background for gold. Will the surging money supply turn gold around and drive it higher? Or will the forces of world deflation combined with central bank selling of gold keep gold in the cellar? Honestly, there's no way of knowing. But we do have the prices, and we do have the charts.

I am including two charts. The first shows the daily price of **gold** (February futures), and as you can see, gold is at the lows, in fact at an 18-year low. The 34-day moving average for gold now stands at 291.

In contrast, I am showing the most profitable of the gold stocks, Barrick Resources. The 34-day MA for ABX now stands at 17 1/2. The extreme low for ABX was struck on December 9 at 15 1/16. It will be important for the whole gold universe if ABX can avoid violating 15. I would like to be optimistic about gold here, but it ain't easy. Ah yes, the turn comes when the sky is darkest and gloom envelopes the land. For gold-philes, it feels like gloom and darkness have arrived.

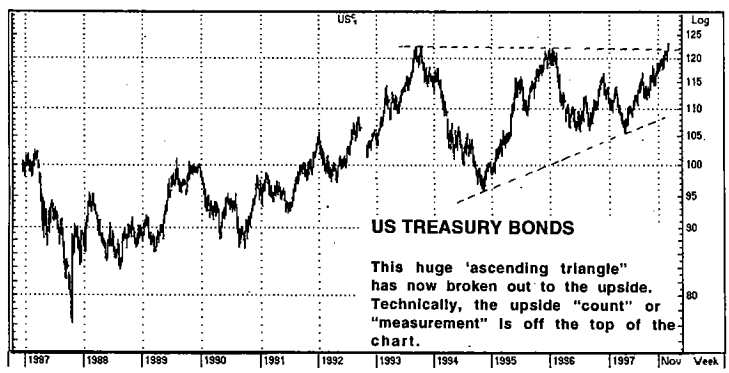
BONDS: The news of the last few months should have knocked bonds down at least 10 points. But that's hardly what happened -- the bonds act as though they are feasting on news that would ordinarily crush them. Business is good, if not very good, employment extremely high, unemployment very low, federal deficit almost disappearing, Fed creating money in torrential amounts. Yet the bonds head higher. What's happening?

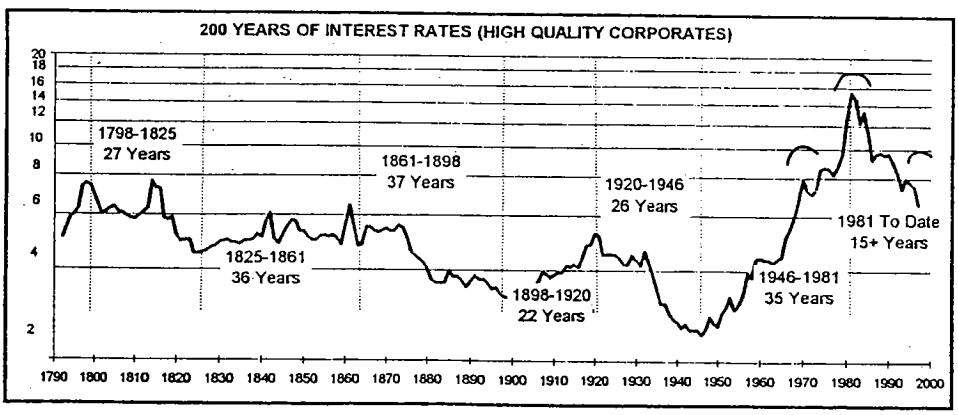
The bond market is obviously looking ahead. Whether they are discounting deflation, whether they are discounting much smaller financing needs by the Treasury, whether they are discounting or reacting to a rush to safety -- or other items as yet unknown, I can't tell. But I can tell you that the bonds are acting very darn well.

A little technical analysis. A few months ago I published Steve Leuthold's LONG-term chart of the interest rates going back 200 years. I noted that the yields had formed a massive head-and-shoulders top formation, and this formation was in the process of breaking down -- towards lower yields. In fact, on a technical measurement the formation allows for yields to drop down to the (would you believe) 4% range.

A second consideration. Most bond bull markets last a quarter century or longer. The current bull market in bonds has only been in force since 1981, a period of 17 years. Based on past precedent, it could have another 5 to 10 years to go.

I'm including a second chart, showing Treasury bonds (the bonds, not the yields) going back to 1987. What we see here is a massive ascending triangle. Last week the bonds broke out above both the '93 and '96 highs, taking the bond futures above 123. Yields on the long T-bond broke below the critical 6% level. On a technical measurement based on this ascending triangle, the bonds could easily rise to 150 or even further. I know this sounds absurd, but if this was a stock you'd be thinking a possible double.





Market gurus have derided the old dividend valuation models since today we are living in another "new era," the new era of the "Goldilocks economy." However, veteran stock market students believe that dividends do matter. For instance, if the Dow was simply to sell at a 3% dividend yield (this was the time-honored "danger level,") the Dow would be literally cut in half. Note that mutual fund buyers are now cutting back substantially on their purchases. But what happens if they start to sell?